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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-78478; File No. SR-C2-2016-014)

August 4, 2016

Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to AIM Retained Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 27, 2016, C2 Options Exchange, Incorporated (the “Exchange” or “C2”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Exchange filed the proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The text of the proposed rule change is available on the Exchange’s website (<http://www.c2exchange.com/Legal/>), at the Exchange’s Office of the Secretary, and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend Rule 6.51 (Automated Improvement Mechanism ("AIM")) to: 1) clarify how orders submitted for electronic crossing into the AIM auction are treated if an auction cannot occur; 2) adopt Interpretation and Policy .10 to Rule 6.51 (AIM Retained Order Functionality) to describe the Exchange's AIM Retained Order ("A:AIR") functionality in the Rules; and 3) make minor edits to Interpretation and Policy .04 to Rule 6.13 (Price Check Parameters) relating to the treatment of complex AIM orders marked A:AIR and correct certain typographical errors. The Exchange notes that this filing is based upon and, in all material respects, substantially similar to a recent filing of Chicago Board Options Exchange, Incorporated ("CBOE") regarding A:AIR functionality.<sup>5</sup> Both AIM and A:AIR functionality are active on CBOE.

Under Rule 6.51 (Automated Improvement Mechanism ("AIM")), a Permit Holder ("Participant") that represents agency orders may electronically execute an order it represents as agent ("Agency Order") against principal interest or against a solicited order provided it submits the Agency Order for electronic execution into the AIM auction ("Auction") for processing. Matched Agency Orders may be processed via AIM subject to certain eligibility requirements

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<sup>5</sup> See Securities Exchange Act Release No. 77848 (May 17, 2016), 81 FR 31978 (May 20, 2016) (SR-CBOE-2016-024) (Order Approving Proposed Rule Change, as Modified by Amendment No. 2 Thereto, Relating to AIM Retained Orders). See also Interpretation and Policy .09 to CBOE Rule 6.74A (AIM Retained Order Functionality).

contained in Rule 6.51(a). Specifically, to be eligible for processing via AIM, the Agency Order must be: (1) in a class designated as eligible for AIM Auctions as determined by the Exchange and within the designated Auction order eligibility size parameters as such size parameters are determined by the Exchange; and (2) stopped as principal or with a solicited order at the better of the national best bid or offer (“NBBO”) or the Agency Order's limit price (if the order is a limit order).<sup>6</sup> Orders submitted for crossing into AIM, which are ineligible for Auction processing will result in both the Agency Order and the matching contra order(s) being cancelled.

Under Rule 6.51(a)(1), an Auction may be conducted in a class designated as eligible for Auctions as determined by the Exchange. Any determinations made by the Exchange, such as eligible classes, will be communicated in a Regulatory Circular pursuant to Interpretation and Policy .05 to Rule 6.51. Notably, AIM functionality is currently not activated in any class on the Exchange.

A:AIR functionality is an enhancement to AIM, which if activated, would allow Participants the flexibility to choose, on an order-by-order basis, whether an Agency Order should continue into the System<sup>7</sup> for processing rather than cancel in the event that an Auction cannot occur.<sup>8</sup> A:AIR functionality essentially allows for the entry of Agency Orders into AIM with contingency processing instructions for handling in the event that the order cannot be

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<sup>6</sup> See Rule 6.51(a).

<sup>7</sup> The System refers to the Exchange’s automated trading system as defined in Rule 1.1 (Definitions).

<sup>8</sup> There are a variety of circumstances in which an AIM order may be submitted to the Exchange for processing, but an auction may not occur. For example, a Participant may submit an order for AIM processing, which is not AIM eligible because one or more of the conditions required for an AIM auction to occur pursuant to Rule 6.51(a) is not present. In addition, an order that is otherwise AIM eligible may not be able to process for a variety of reasons, including, but not limited to circumstances in which AIM functionality is suspended. In either of such cases, A:AIR functionality may allow the Agency Order to process despite the overall order not being AIM eligible.

processed via Auction. For example, using A:AIR functionality, a Permit Holder enters an Agency Order to buy 10 standard contracts at the market along with a matched solicited contra order to sell 10 standard contracts at \$1.21. At the time the A:AIR order is entered, the NBBO is \$1.00 to \$1.20, with a Customer order to sell 30 contracts at \$1.20 resting at the top of the book alone. Here, the order would not be eligible for submission into AIM because the Agency Order was not stopped with a solicited order priced better than the NBBO.<sup>9</sup> As a result, pursuant to Rule 6.51(a)(2), the Auction would not begin. Whereas both the Agency Order and solicited order would have cancelled if the order were not marked A:AIR, in this case, because the order was marked A:AIR, the Agency Order would route to the automated trading system for processing and trade against the resting Customer – the solicited order would still be cancelled. Again, however, had the Permit Holder not marked this order A:AIR, both the Agency Order and solicited order would cancel.

Currently, A:AIR functionality is not explicitly defined in the Exchange's AIM rules.<sup>10</sup> Accordingly, this filing is intended to further codify, clarify, and describe A:AIR functionality in the Rules. Specifically, the Exchange proposes to adopt Interpretation and Policy .10 to Rule 6.51 (AIM Retained Order Functionality), under which the Exchange would define an A:AIR order as the transmission of two or more orders for crossing pursuant to Rule 6.51, with the Agency Order priced at the market or a limit price in the standard increment for the option series and marked with a contingency instruction to route the Agency Order for processing and cancel any contra orders if an Auction cannot occur (including if the conditions described in Rule

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<sup>9</sup> See Rule 6.51(a)(2).

<sup>10</sup> A:AIR functionality is generally referred to in the Rules, although not using that term. See Interpretation and Policy .04 to Rule 6.13 (Price Check Parameters) at paragraphs (c)(5), (d), (f)(3), and (h)(4) referring to orders that instruct the System to process the Agency Order as an unpaired order if an AIM Auction cannot be initiated.

6.51(a) are not met).

Furthermore, to ensure that A:AIR orders are properly priced to allow the Exchange to book the Agency Order in the event an Auction cannot occur, proposed Interpretation and Policy .10 to Rule 6.51 would provide that orders marked “A:AIR” with Agency Orders that are not priced at the market or that are priced with a limit price not in the standard increment for the option series in which they are entered would be rejected. For example, if a Participant were to submit a matched Agency Order into AIM for processing in a class with a minimum increment of a nickel, which was stopped with a contra order at \$0.07, both the Agency Order and the contra order would be rejected because the order, which is not priced in the minimum increment for the class, would not be eligible for AIM processing and because the System would not be able to book an order at \$0.07 in a class with a minimum increment of a nickel. Notably, this provision of proposed Interpretation and Policy .10 to Rule 6.51 is consistent with Exchange rules that only permit orders at the standard increment to enter the book.<sup>11</sup> Finally, proposed Interpretation and Policy .10 to Rule 6.51 would provide that A:AIR order functionality could be made available on those order management platforms as determined by the Exchange and announced via Regulatory Circular. This provision is intended to make clear that A:AIR functionality may not be available on all trading platforms in use on the Exchange.<sup>12</sup>

The Exchange also notes that although orders submitted into AIM, which are not marked A:AIR and are ineligible for Auction processing will result in both the Agency Order and the matching contra order(s) being cancelled, the Rules do not explicitly provide as much.

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<sup>11</sup> See Rule 6.4.

<sup>12</sup> A:AIR functionality is not currently supported on the PULSe trader workstation. PULSe is an order handling tool used for the manual handling of orders. Thus, when ineligible AIM orders would be rejected back to PULSe users, a person is present to decide how best to handle such orders. PULSe users can either re-route such orders to be booked or for alternative electronic processing on the Exchange.

Accordingly, the Exchange proposes to add language to Rule 6.51(a) to provide that in the event that a Participant submits a matched Agency Order for electronic execution into the Auction that is ineligible for processing because it does not meet the conditions described in paragraph (a), both the Agency Order and any solicited contra orders will be cancelled unless marked as an AIM Retained order pursuant to proposed Interpretation and Policy .10 to Rule 6.51.<sup>13</sup>

The Exchange also proposes to make minor changes to Interpretation and Policy .04 to Rule 6.13 regarding price reasonability checks on complex orders to harmonize references to A:AIR functionality in Rule 6.13 with the language in proposed Interpretation and Policy .10 to Rule 6.51. Specifically, the Exchange proposes to modify Interpretation and Policy .04(c)(5), (d), (f)(3), and (h)(4) to Rule 6.13 (Price Check Parameters) to change references to AIM orders that instruct the System to process the Agency Order as an unpaired order if an AIM auction cannot be initiated, to instead refer to A:AIR orders as defined in proposed Interpretation and Policy .10 to Rule 6.51. These changes are non-substantive and intended only to harmonize existing references to A:AIR functionality currently in the Rules with the definition of A:AIR orders set forth in proposed Interpretation and Policy .10 to Rule 6.51. The proposed rule change also makes non-substantive changes in these paragraphs to capitalize the defined term Agency Order, consistent with Rule 6.51.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of

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<sup>13</sup> Notably, the A:AIR functionality may be primarily used by smart router technology to ensure that ineligible AIM orders are submitted into the System for processing and not cancelled. Whereas traditional brokers and dealers are equipped to manually handle cancelled orders that are returned to them and may revise the cancelled orders' terms or contact their customers for further instructions, smart routers are generally all electronic algorithmic systems that may not allow for manual handling of cancelled orders.

Section 6(b) of the Act.<sup>14</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>15</sup> requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>16</sup> requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the Exchange believes that A:AIR functionality makes the Exchange's price improvement mechanisms [sic] easier to use and minimizes the risk of orders being mishandled on the Exchange. The A:AIR functionality provides opportunities for execution of Customer orders that a Participant submits for crossing via AIM that cannot be auctioned. The Exchange believes that this functionality mitigates the risk that inadvertent mishandling of Agency Orders (i.e. Customer orders) will cause marketable Customer orders to go unfilled. The Exchange believes that such outcomes serve to protect investors' interests by helping to ensure that ineligible AIM Agency Orders are processed in accordance with customer instructions rather than cancelled. Accordingly, the Exchange believes that the proposed rule change is consistent with the purposes of the Act.

In addition, the Exchange believes that A:AIR functionality promotes competition

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<sup>14</sup> 15 U.S.C. 78f(b).

<sup>15</sup> 15 U.S.C. 78f(b)(5).

<sup>16</sup> Id.

amongst market participants by allowing more orders to be processed. Finally, the proposed rule change seeks to provide additional clarity and completeness in the Rules regarding functionalities that may be made available on the Exchange. The Exchange is continuously updating the Rules to provide additional detail, clarity, and transparency regarding its operations and trading systems. The Exchange believes that the adoption of detailed, clear, and transparent rules reduces burdens on competition and promotes just and equitable principles of trade.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange notes that price improvement mechanism enhancements such as A:AIR functionality are widely used across the national options exchanges. The Exchange believes that offering additional functionalities and enhancements to its price improvement mechanisms [sic] promotes intermarket competition. The exchanges have developed these mechanisms in order to provide market participants diverse opportunities to seek valuable price improvement and as a means to compete with one another for order flow. The U.S. options exchanges are continuously making enhancements and adding functionalities to their price improvement mechanisms in order to provide more competitive marketplaces for market participants and better compete with one another. The Exchange believes that enhancements to such mechanisms promote intermarket competition for order flow between the exchanges. A:AIR functionality is simply one of many enhancements that the Exchange has made to AIM for this purpose.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange neither solicited nor received written comments on the proposed rule change.



### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not:

- A. significantly affect the protection of investors or the public interest;
- B. impose any significant burden on competition; and
- C. become operative for 30 days from the date on which it was filed, or such shorter

time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>17</sup> and Rule 19b-4(f)(6)<sup>18</sup> thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission will institute proceedings to determine whether the proposed rule change should be approved or disapproved.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-C2-2016-014 on the subject line.

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<sup>17</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>18</sup> 17 CFR 240.19b-4(f)(6).

Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-C2-2016-014. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-C2-2016-014, and should be submitted on or before [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>19</sup>

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<sup>19</sup> 17 CFR 200.30-3(a)(12).

Robert W. Errett  
Deputy Secretary

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